Testimony of

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Climate Change Finance: Providing Assistance for Vulnerable Countries

Chairman Faleomavaega, Ranking Member Manzullo, members of the committee, thank you for the opportunity to testify on the critical challenge of ensuring U.S. financial support for climate change efforts in developing countries. My name is Elliot Diringer, and I am the Vice President for International Strategies at the Pew Center on Global Climate Change.

The Pew Center on Global Climate Change is an independent non-profit, non-partisan organization dedicated to advancing practical and effective policies to address global climate change. Our work is informed by our Business Environmental Leadership Council (BELC), a group of 46 major companies, most in the Fortune 500, that work with the Center to educate opinion leaders on climate change risks, challenges, and solutions. The Pew Center is also a founding member of the U. S. Climate Action Partnership (USCAP) , a coalition of 23 leading businesses and five environmental organizations that have come together to call on the federal government to enact strong national legislation to significantly reduce U.S. greenhouse gas (GHG) emissions.

Mr. Chairman, the Pew Center believes that providing sustained financial support to developing countries is in the U.S. national interest and an essential ingredient for a meaningful global response to the urgent challenge of climate change. While some developing countries have adequate resources to finance their own climate efforts, most do not. They need our help both in mitigation (deploying policies and technologies to reduce their rapidly rising greenhouse gas emissions) and in adaptation (coping with the unavoidable impacts of a warming climate). Delivering adequate support will require decisions here in Washington to mobilize the United States' fair share of the necessary resources. And it will require effective multilateral agreements ensuring that in return, all major economies – both developed and developing – contribute equitably to the global climate effort.

In my testimony, I would like to outline some of the reasons we believe it is in our strong national interest to provide sustained climate support to developing countries; suggest principles to guide a U.S. climate finance strategy at home and abroad; and recommend domestic and international policy frameworks to generate and effectively deploy climate finance.

My principal points are as follows:

- There are strong environmental, security, economic, humanitarian and diplomatic rationales for supporting developing countries' climate efforts. Developing countries are unlikely to commit to strong climate action without assurances of sustained finance, severely weakening prospects for an effective global response to climate change. Providing this support will reduce the United States' exposure to climate impacts and related security risks, and will help ensure strong markets for U.S. clean energy technologies.
- In both domestic policy and multilateral negotiations, U.S. strategy on international climate finance should promote reliability, accountability, coherence, efficiency and the preservation of national sovereignty.
- Key international objectives should be the establishment of a new multilateral climate fund, as agreed in the Copenhagen Accord; creation of a finance body to promote coherence and coordination among multilateral and bilateral finance efforts; and adoption of clear guidelines for the verification of financial flows and supported actions.
- These steps should be agreed only in the context of a balanced package that includes effective international procedures to verify the mitigation actions of all major-emitting countries.
- Domestically, Congress should approve the Administration's request for increased international climate appropriations in FY 2011; establish a dedicated funding source, such as a set-aside of emission allowances, to sustain higher levels of finance in the future; and establish an interagency trust fund board to allocate these funds, subject to Congressional oversight.

Why the U.S. Should Provide Sustained Climate Assistance to Developing Countries

Climate change is a global predicament in which causes and effects are distributed unequally. All countries face the consequences of a warming climate. However, some countries, including the United States, have far greater capacity to cope with them. These same countries, by and large, also bear far greater responsibility for the cumulative greenhouse gas emissions that have begun to alter our climate.

For these reasons, the world's developed countries, including the United States, have committed to lead the global climate effort and to support the mitigation and adaptation efforts of developing countries. These general commitments are contained in the 1992 U.N. Framework Convention on Climate (UNFCCC), signed by President George H. W. Bush and unanimously ratified by the Senate.

Responsibility, however, is only one rationale for fulfilling these commitments. Sustained U.S. support for developing countries is in our national interest from multiple perspectives:

- *Environmental* – Dangerous climate change can be averted only with the concerted efforts of all major emitting countries. While some have begun to take action, and such unilateral efforts are likely to grow, achieving a critical mass of effort on a global scale will require durable multilateral agreements through which countries can be confident that all are undertaking their fair share. For developing countries to sign on to such agreements, they will need reasonable assurance that developed countries will significantly scale up their financial support. Sustained U.S. support is therefore essential for the global deal we need to reduce our exposure to potentially catastrophic climate risks.

- *National security* – The U.S. military now recognizes that unabated climate change poses rising risks to our national security and new demands on our military resources. In its latest Quadrennial Defense Review, the Pentagon says climate change may act as "an accelerant of instability or conflict, placing a burden to respond on civilian institutions and militaries around the world."[1] In strained regions, chronic drought, rising seas, extreme weather and other climate impacts could undermine weak governments, induce mass migrations, and trigger or heighten resource competition, contributing to social instability and, potentially, armed conflict.[2] U.S. support would mitigate these risks, first, by helping to reduce global GHG emissions, thereby limiting impacts, and second, by helping poor, highly vulnerable countries anticipate and manage the stresses of climate change.

- *Economic* – China, Germany and other countries are taking a lead in a global clean energy market projected to attract more than $1.5 trillion in investment over the coming decade.[3] As the United States positions itself to compete, it has a vested interest in ensuring that developing countries have the technical, institutional and financial capacity to adopt clean energy technologies. U.S. finance can help establish, and ease the entry of U.S. firms into, these new markets.

- *Humanitarian* – An important dimension of U.S. leadership is our readiness to assist those in need, whether the victims of Haiti's tragic earthquake or the millions in Africa suffering HIV/AIDS. Within 10 years, global warming may reduce crop yields in parts of Africa by as much as half; by 2050, rising seas could displace as many as 30 million people in Bangladesh, and receding glaciers could leave a billion

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[1] Department of Defense, 2010. *Quadrennial Defense Review Report*, Page 85. Available at http://www.defense.gov/qdr/images/QDR_as_of_12Feb10_1000.pdf.

[2] Fingar, T., 2008. *Testimony Before the House Permanent Select Committee on Intelligence and the House Select Committee on Energy Independence and Global Warming*, 25 June 2008 and; Center for Naval Analyses, 2007. *National Security and the Threat of Climate Change*, Military Advisory Board, Center for Naval Analyses (CNA), April 2007. Available at http://www.cna.org/sites/default/files/National%20Security%20and%20the%20Threat%20of%20Climate%20Change.pdf.

[3] Pew Center on Global Climate Change, 2010. *Clean Energy Markets: Jobs and Opportunities*, April 2010 Update. Available at http://www.pewclimate.org/publications/brief/clean-energy-markets-jobs-and-opportunities.

others across Asia facing chronic water shortages.[4] Increasingly, the United States' humanitarian record will be seen against a backdrop of worsening climate impacts.

- *Diplomatic* – A willingness to assist vulnerable countries is among the strongest levers available to the United States to secure meaningful climate commitments from China and other major developing countries. In Copenhagen, China showed flexibility on U.S. demands for transparency only after Secretary of State Clinton proposed a long-term finance goal, which fractured the developing country bloc by drawing support from many least developed and small island countries. With further progress on finance, this dynamic can be expected to continue as negotiations go forward.

Policy Context and Challenges

The Copenhagen Accord represents an important step toward an effective international climate framework. Although nonbinding, the Accord reflects a political consensus among world leaders on key elements, including: a goal of limiting warming to 2 degrees Celsius; a balanced but differentiated approach to mitigation, with economy-wide emission targets for developed countries and nationally appropriate actions for developing countries; and agreement in principle on how these efforts are to be verified.[5] To date, 109 countries have associated with the Accord. Fifty-six countries accounting for more than 80 percent of global emissions – including China and the other major emerging economies – have pledged specific targets or actions.[6]

In the area of finance, the Accord calls for a new Copenhagen Green Climate Fund; sets a goal of $30 billion in mitigation and adaptation assistance from developed countries in 2010-2012; and sets a goal of mobilizing $100 billion a year in public and private finance for developing countries by 2020, in the "context of meaningful mitigation actions and transparency in implementation."

Fulfilling the Copenhagen Accord requires action at home by the United States and other countries and further agreement among parties on operating rules and mechanisms. With respect to finance, the immediate priority is delivering on the goal of $30 billion in "fast-track" support. At President Obama's request, Congress increased international climate appropriations more than three-fold in FY 2010, to $1.3 billion. The President has proposed a further increase, to $1.9 billion, in FY 2011. These funds would help address urgent needs and, as an important signal of Congress' intent, would help advance U.S. negotiating objectives. The Pew Center strongly urges Congress to fully fund this request.

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[4] Intergovernmental Panel on Climate Change, 2007. *Summary for Policy Makers.* Available at http://www.ipcc.ch/pdf/assessment-report/ar4/wg1/ar4-wg1-spm.pdf.

[5] *Copenhagen Accord.* Available at http://unfccc.int/resource/docs/2009/cop15/eng/11a01.pdf#page=.4.

[6] The 27 Member States of the European Union are counted here as a single entity. Emission reduction targets pledged by developed countries are available at http://unfccc.int/home/items/5264.php. Mitigation actions pledged by developing countries are available at http://unfccc.int/home/items/5265.php.

The broader challenge on climate finance is two-fold. First, the United States must establish a domestic strategy to generate and effectively manage its share of the long-term finance envisioned under the Accord. Second, the United States must work with other countries to establish multilateral financial arrangements compatible with this domestic funding strategy. I will offer recommendations in both of these areas later in my testimony.

The upcoming U.N. Climate Conference in Cancún presents a major opportunity to begin elaborating the international financial architecture. Any further agreement on finance, however, should come in the context of a balanced package also advancing other key issues. Chief among these is the issue of transparency. Having agreed in Copenhagen that all parties' actions are to be verifiable – and that developing country actions are to undergo "international consultation and analysis" – parties must now begin to establish this system of accountability.

We believe that in the long run the goal must be a comprehensive treaty with binding commitments for all major economies. We will likely get there, however, only in stages. For now, the objective should be to build on the Copenhagen consensus with nuts-and-bolts decisions on finance, transparency, and other key operational areas. As the architecture takes shape, and countries move forward with domestic implementation, they will hopefully gain the confidence needed to convert their current political pledges into more ambitious binding commitments.

Objectives of a U.S. Climate Support Strategy

The Copenhagen Accord, as noted, envisions a mix of public and private finance for developing countries. While there is no consensus on the appropriate mix, there is broad acceptance that the carbon market and other private finance will comprise a substantial portion. Indeed, with a strong carbon market, private finance could generate a substantial majority of needed flows. There is also broad recognition, however, that a significant increase in public finance is needed to build mitigation capacity, so that countries can establish the policies and practices necessary to attract private investment, and to support adaptation. Our recommendations focus primarily on the public finance portion.

We believe that U.S. strategy on international climate finance, both in domestic policy and in multilateral negotiations, should reflect the following objectives:

- *Reliability* – To be politically credible and effective, new support must be steady and predictable. Strong, stable climate agreements will not be feasible without reliable financial flows. Nor will developing countries be able to build the capacities needed to become more self-reliant in meeting the climate challenge.

- *Accountability* – Clear, workable guidelines are needed to verify the delivery of support and the performance of supported actions.

- *Coherence* – Support will flow through multiple channels – public and private, bilateral and multilateral – to address a wide range of needs. Mechanisms are needed to set priorities and to promote coordination and consistency.

- *Efficiency* – Rapidly scaling up support calls for fully leveraging, and not replicating, the capacities of existing institutions and for deploying public finance in ways that maximally leverage private flows.

- *Sovereignty* – National prerogatives must be respected and preserved. Donor countries should retain discretion on the means of generating, and avenues for delivering, increased finance. Recipient countries should be able to access finance directly (through national, rather than multilateral, implementing entities).

An International Climate Finance Architecture

Climate support is presently provided through an array of bilateral and multilateral channels, including a number of funds established under the UNFCCC and the Kyoto Protocol. In this largely ad hoc structure, funding levels are erratic and well below assessed needs, there is little coordination among the various funding entities, and developing countries frequently complain of difficulty in accessing those funds that are available.

A major aim of the ongoing UNFCCC negotiations is the establishment of new financial arrangements to ensure stronger, predictable flows and improved access to funding. Many developing countries have advocated a comprehensive new apparatus under the UNFCCC to centrally gather and disburse funding for the full range of mitigation and adaptation needs. We believe a more practical and politically viable approach is a finance framework that promotes adequate, reliable flows by encouraging a variety of funding mechanisms and channels, while ensuring greater consistency, coordination and accountability. The major elements of this enhanced architecture should include: a new multilateral climate fund, as agreed in the Copenhagen Accord; a new finance body to advise the UNFCCC Conference of the Parties (COP); and clear guidelines for the verification of financial flows and supported actions.

A New Climate Fund – Principal issues in the design of a new climate fund include its intended uses, its governance structure, and how it will be funded.

We believe a new multilateral climate fund should serve as a principal, but not exclusive, mechanism for delivering public finance to developing countries. It could support any or all of the following activities: capacity building (to help countries analyze mitigation potentials, develop national policies, and institute measurement and verification systems); adaptation planning and implementation; technology deployment; forestry-related measures; and other types of mitigation programs. In determining the fund's scope, countries must assess and modify existing UNFCCC funds accordingly to avoid funding gaps and redundancies.

The new fund should be governed by an independent board operating under the guidance of, and accountable to, the COP, but not under its direct authority. This would allow the COP to set broad policy directions and maintain oversight, while reducing the risk of procedural delays and political interference. For this arrangement to be acceptable to developing countries, many of which prefer that the fund be under the direct authority of the COP, it is essential that the board's composition and decision-making provide for balanced representation. These could be modeled on the provisional Climate Investment Funds (CIFs) formed in 2008 by the United States and other major economies. The CIFs' Trust Fund Committees include equal representation from contributor and recipient countries and operate by consensus.

Another concern is the new funds' relationship to existing multilateral financial institutions, in particular the World Bank. Many developing countries object to the Bank's donor-weighted governance structure and feel it has been unresponsive to their concerns; stakeholder groups are critical of its historic support for carbon-intensive energy development. While both sets of concerns warrant continued reforms at the Bank, they should not preclude it from an appropriate role in a new climate fund. Given the urgency and scale of the climate finance challenge, countries must take full advantage of available capacities and expertise. The Bank should be a candidate to serve as the new fund's trustee, a strictly fiduciary role. And parties should explore seconding staff from the Bank and from other multilateral development banks and agencies to form an independent secretariat supporting the new climate fund.

A wide range of proposed funding sources are being examined by the Secretary-General's High-Level Advisory Group on Climate Change Financing, but near-term agreement on any particular revenue mechanism, particularly one at the international level, appears unlikely. In the absence of such a mechanism, countries should agree on an indicative scale of assessment establishing their relative contributions to the new climate fund and set funding targets through periodic pledging (every three to five years); each should decide for itself how to generate its respective contribution. This scale of assessment could take into account factors such as a country's total and per capita emissions and GDP, and should be evolving, so that emerging economies also contribute as they achieve higher levels of development.

A UNFCCC Finance Body – As noted, a new climate fund would be one among many means of delivering climate support. This disaggregated architecture has the advantage of encouraging multiple bilateral and multilateral channels, thereby achieving the highest feasible overall flow. A mechanism is needed, however, to promote some degree of coordination and coherence among these efforts.

We believe this role is best served by a new UNFCCC body appointed by the COP to advise it on finance-related issues. Specifically, this finance body, comprised of parties and independent experts, could:

- Recommend broad funding priorities to guide the allocation decisions of multilateral funds and bilateral donors;
- Continually assess finance needs and progress toward meeting finance objectives;
- Review the performance of, and recommend further guidance to, UNFCCC funds;
- Provide a forum where multilateral and bilateral donors could seek to coordinate their efforts;
- Promote harmonization of application procedures; and
- Recommend guidelines for the measurement and verification of finance.

Verification – Parties have agreed in principle that their mitigation actions – and that support for developing country actions – are to be measurable, reportable and verifiable (MRV). A goal for Cancún should be agreement on the basic parameters of an MRV system so that detailed guidelines can then be developed.

Verification of finance will require stronger tracking and reporting of financial flows and some form of UNFCCC review. For the system to be credible, there must be some further delineation of what flows, both public and private, qualify as "climate finance."

Developing countries agreed in Copenhagen that "supported" mitigation actions would be subject to "international verification." In the case of bilateral finance, the United States and other donors can be expected to apply their own verification standards. But COP guidance is needed to ensure some consistency among them and to define how MRV applies to multilateral support.

A balanced agreement must also address MRV of the mitigation actions taken by developing countries without international assistance, which under the Copenhagen Accord are subject to "international consultations and analysis." This includes a substantial majority of the actions pledged by China and other major emerging economies. We believe that effective MRV of these unilateral efforts will require: biennial GHG inventories and implementation reports from developing countries; a technical review and report by experts; an open peer review based on the expert report and parties' inputs; and publication of all reports and the peer review conclusions. Similar MRV procedures should apply to the mitigation actions of developed countries as well.

Domestic Policy Issues

In the domestic policy context, there are two principal needs: a stable funding base enabling the United States to provide sustained support for developing country efforts; and a mechanism to allocate and coordinate those resources and ensure strong Congressional oversight.

A Stable Funding Base – Unless it is prepared to support some form of international revenue-generating mechanism, the United States must rely on domestically generated resources for its share of future international climate finance. Past U.S. climate support has come through appropriations by Congress to multiple agencies, including the Departments of State, Treasury, Energy, Commerce and Agriculture, the U.S. Agency for International Development (USAID), and the Environmental Protection Agency (EPA). The core climate assistance budget averaged \$237 million a year from 2001 to 2009,[7] before rising to \$1.3 billion in FY 2010.

We urge Congress to approve the President's request for increased appropriations in FY 2011, and to consider a further increase in FY 2012, enabling the United States to provide a reasonable share of the \$30 billion in "fast-start" resources pledged collectively by developed countries in Copenhagen. However, looking toward 2020, with competing demands on the federal budget and the growing imperative of deficit reduction, there is no certainty that appropriations alone can provide the level of sustained support that is needed. We believe that the United States will prove a more reliable partner in the global climate effort, and that the

[7] Office of Management and Budget, *Federal Climate Change Expenditures, Report to Congress* for Fiscal Years 2003-2008 and 2011.

prospects for effective climate agreements will be greatly enhanced, if Congress establishes a dedicated source of funding.

Ideally, this source should derive from GHG-generating economic activities, and thereby help to correct the market failures that contribute to climate change. Our first choice would be a set-aside of emission allowances in an economy-wide cap-and-trade system regulating U.S. greenhouse gas emissions. While there now appears little prospect of cap-and-trade legislation in this Congress, we continue to believe strongly in the value of a market-based approach to reducing U.S. emissions. Properly designed, a cap-and-trade system can minimize the costs of meeting our environmental goals, create an ongoing incentive for technological innovation, and generate resources for critical climate investments, including international finance.

We commend the House for its approval of H.R. 2454, the American Clean Energy and Security Act of 2009, and the inclusion of specific set-asides to support adaptation, reduced deforestation and technology deployment in developing countries. At projected allowance prices, these set-asides would generate about $8.5 billion in public finance for developing countries in 2020.[8] According to EPA's analysis, the purchase of international emission offsets authorized under H.R. 2454 could also generate on the order of $20 billion of private investment in developing countries in 2020.[9] Combined, these set-asides and offset purchases would meet or exceed the presumed U.S. share of the $100 billion goal set under the Copenhagen Accord.

Other potential sources of public finance that we believe may be worth exploring include:

- International shipping and aviation – Two sectors drawing particular attention from the international community because of their trans-boundary nature and rising emissions are international shipping and aviation. A number of the proposals by countries to limit or reduce their emissions could serve simultaneously to generate finance for developing countries. Some parties have proposed international levies on bunker fuels or other forms of emission charges. Alternatively, countries could agree to apply such charges nationally and to dedicate a portion of the proceeds to international climate finance. In such an approach, the United States would directly administer any charges at domestic ports and decide how to apportion the resulting revenues.

- Fossil fuel subsidies/royalties – Another option is to redirect some of the federal tax subsidies provided for fossil fuel production, or of the federal royalties it generates. The United States and other G20 countries agreed last year in Pittsburgh to phase out "inefficient fossil fuel subsidies."[10] The President's proposed FY 2012 budget calls

[8] Purvis, N. and Stevenson A., 2010. *International Provisions in U.S. Climate Legislation.* Available at http://www.climateadvisers.com/pdf/International%20Provisions%20in%20U.S.%20Climate%20Legislation.pdf.

[9] Environmental Protection Agency, 2009. *EPA Analysis of the American Clean Energy and Security Act of 2009—H.R. 2454 in the 111th Congress*, 23 June 2009. Available at http://epa.gov/climatechange/economics/pdfs/HR2454_Analysis.pdf.

[10] *G20 Leaders' Statement*, The Pittsburgh Summit, 24-25 September 2009. Available at http://www.g20.org/Documents/pittsburgh_summit_leaders_statement_250909.pdf.

for ending a number of oil and gas subsidies, generating an estimated $39 billion in revenue through 2020.[11]

- Levy on international offsets – Another potential source, assuming the establishment of a federal cap-and-trade system, would be a levy on international emission offsets entering the domestic market. A similar levy on the international Clean Development Mechanism presently supports the Adaptation Fund under the Kyoto Protocol.

Coordinating U.S. Support – Regardless of the source of finance, a coherent strategy for sustained U.S. support requires a mechanism to coordinate across federal entities. Ideally, Congress should establish a trust fund to receive appropriated or dedicated funds and a board to oversee it. The board would develop a long-term climate support strategy and, on that basis, make annual allocations to bilateral and multilateral programs.

To best align the funding strategy with broader U.S. diplomatic objectives, the board should be chaired by the Secretary of State. Other members should include the Secretaries of Treasury, Energy, Agriculture and Commerce, and the Administrators of USAID and EPA. The board should report regularly to Congress, its executive director should be Senate-confirmed, and Congress should use other means at its disposal to ensure strong oversight

In conclusion, Mr. Chairman and members of the committee, we believe sustained U.S. support for climate efforts in developing countries is a sound and prudent investment in the environmental, economic and national security of the United States. We strongly urge Congress to increase appropriations for "fast-track" finance, and to establish the means for providing long-term support in the context of agreements ensuring that all major economies contribute equitably to the global climate effort. I would be pleased to answer your questions.

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[11] Office of Management and Budget, 2010. *Budget of the U.S. Government, Fiscal Year 2011*. Available at http://www.whitehouse.gov/omb/budget/fy2011/assets/budget.pdf